African Development Bank Group

Nigeria Country Department

GOVERNORS' FORUM

Brief on the
"The Role of Development Partners in Sub-National Development"

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Rationale and Role of Development Banks

Rationale for and definition of national development banks

A standard argument for why development banks should be promoted is that such banks can fill

1. **The gaps left by private financial institutions**, which are often geared towards commercial activities. **The main gap is usually insufficient finance for economic transformation.** The latter typically involves large-scale projects with long maturation periods, which require **long-term finance** and thus imply risks that banks are unwilling to undertake. In addition, many large-scale projects generate **positive externalities and therefore social returns that are greater than private returns.** The provision of long-term finance is also lacking due to the **funding of financial institutions, which is often short-term.** That is, long-term finance requires maturity transformation, which involves a risk that banks usually prefer to avoid. For these reasons, development banks are designed and mandated to fulfil this role. At the national level, development banks can be instrumental not only in addressing market failures, such as the lack of provision of long-term finance due to the risks and uncertainties involved, but as a critical tool in supporting a proactive development strategy.

These institutions were able to remove bottlenecks but also had the capacity to anticipate future needs arising from rapid and transformative development (Hermann, 2010). Concretely, development banks provide finance for long-term investment, including in capital intensive industries.

2. In addition, such banks provide both **lending and equity participation,** meaning that they have a clear interest in the close monitoring of projects, thus developing a special form of relationship banking. That is, the banks have a hands-on approach whereby they not only provide close project monitoring but also are in a position to nominate directors to the boards of the companies to which they lend and in which they have an equity stake.

3. Choice of Technology: Moreover, developing banks have in-house technical expertise that allows them to participate in decisions involving choices of technology, scale and location.

4. Development banks can also help raise capital elsewhere by underwriting the issuance of equity securities. Underwriting implies a leverage capacity, but is not limited to this latter feature. **Development banks can leverage resources by attracting other lenders** that do not have the same technical capacity to assess a project's viability and potential, as well as by **providing guarantees**.

5. In addition, development banks can play a **countercyclical role**, helping sustain overall investment levels and protect the productive structure of a country during economic downturns. Protecting existing industries is not only about correcting market failures but, rather, **creating and shaping markets and strategic policies for development** important in facilitating a more rapid recovery and because doing so facilitates the emergence of new and innovative industries critical for economic transformation, given the complementarities between new and established industries (Hermann, 2010, based on Gerschenkron, 1962:10).

A World Bank survey defines a development bank as "a bank or financial institution with at least 30 per cent State-owned equity that has been given an explicit legal mandate to reach socioeconomic goals in a region, sector or particular market segment" (Luna-Martinez and Vicente, 2012:4). In a report by IADB on public development banks, the latter are defined as financial institutions "from the State whose mandate consists of promoting socioeconomic development through the financing of activities, sectors or specific economic segments" (Olloqui, 2013:14).

Funding Structure: The funding structures of such banks is diverse and can take different forms, such as the following: deposit-taking from the public; resources from financial institutions, including multilateral organizations; debt issuance in national and/or international capital markets; equity issuance; institutional savings; and government transfers. The World Bank survey shows that 41 per cent of the surveyed institutions take deposits, 89 per cent borrow from other financial institutions or issue debt in local markets, 40 per cent receive budgetary transfers from the Government and, importantly, 64 per cent benefit from government guarantees on the debt they issue. The exact funding mix is important in determining their ability to pursue their socioeconomic goals. For example, half of the banks surveyed by the World Bank provide credit at subsidized interest rates and two thirds claim that financing for such subsidies comes from government transfers. In some cases, subsidy financing comes from cross-subsidization. Development banks may have broad or specialized mandates. Those with broad mandates often provide finance for a wide range of sectors and activities that are in line with their mandate of supporting a country's socioeconomic development. Within their broad mandates, such banks are able to diversify risk over time and build technical expertise in different areas. Specialized banks focus on specific sectors, such as agriculture or export activities, or on specific market segments, such as small and medium-sized enterprises (SMEs). Their exact funding mix greatly influences the way in which their resources are mobilized, that is, the kinds of projects they fund and the interest rates they charge on their loans. Banks that have a greater reliance on market sources of finance tend to give greater weight to market considerations when funding projects, and less so to their social and developmental benefits.

Introduction

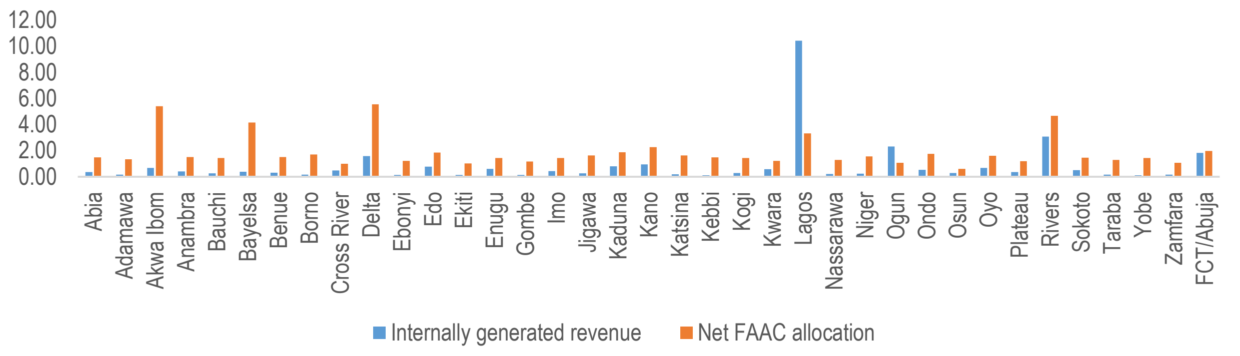
Nigeria, a diverse country filled with great potentials and complex challenges, runs a federal system of government enforced by the constitution, which recognizes three levels of government; the Federal Government, 36 State Governments, the Federal Capital Territory, and 774 Local Government Area Councils, with each levels having defined powers under the constitution.

The 1999 constitution (last amended in 2017) allows the State Governments to have autonomy in the delivery of basic economic and social services, either directly/Independently or through/in collaboration with the Local Governments. The Federal Government however holds the supreme authority in the area of policy development and coordination, macroeconomic management, provision of national security and foreign affairs.

1 Role of subnational governments in economic development

Nigeria is enormously blessed with various natural resources across its six geo-political zones, with the various states having their various potentials and resources. The primary responsibility of the State and Local Government is to provide basic economic services and they play a crucial role in attaining the country's development agenda. State actors are largely faced with limited revenue due to their inability to harness their natural resources and leverage their competitive advantages that will attract investment, promote domestic resource mobilization and reduce dependence on Federal transfer allocations (FAAC, JAAC, Refunds, and Bailouts). State actors needs to identify the sectors in which they have a comparative advantage to generate revenue to finance infrastructures. Lagos State has the highest internally generated revenue compared to other states while Yobe State has the least share. In terms of Federal allocation, Delta State collects the largest Share next to Akwa Ibom as illustrated in Figure 1. These States also contribute the most to the federal revenue base, through oil revenues.

Figure 1: Internally generated revenue Vs FACC Allocations Across States



Source: National Bureau of Statistics

To support the provision of basic services which States have been unable to efficiently provide, Sub-nationals engage in the provision of basic infrastructures such as portable water supply, sanitation, construction and rehabilitation of State and Local Government roads, Health Centers, Community Schools and Vocational Centers Etc. Despite the autonomy of the State in public financial management and Service delivery, efforts by the states are marred by weak technical and institutional capacities.

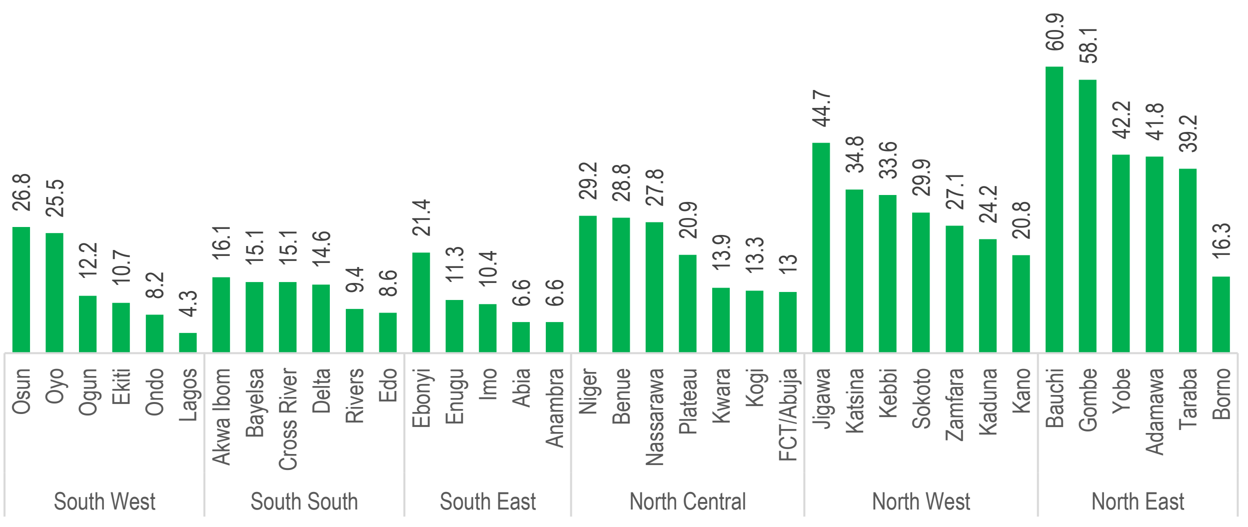
In the current environment, the two big challenges that sub-nationals have to address are employment and infrastructure. The increasing number of unemployed persons from 18.8% in Q3 2017 to 23.1% in Q3, 2018 (NBS, 2018) poses a threat to the country's development. Tackling these issues will have a positive effect on productivity and livelihoods. Tied to these is the overbearing need to focus on the Health and Education sectors to address the core issues of standards and delivery of service amongst other critical matters.

1.1 An overview of the various sectors that contribute to economic development

1.1.1 Education

Nigeria has a population over 190 million which accounts for 20 % of the population of sub-Saharan population (SSA) and is projected to become the third most populous country by 2040 (World Bank, 2018). Education is very vital for national development and State actors are encouraged to invest in the educational life of their people because an educated population essentially leads to prosperity. Lessons show that countries that invest a significant amount of their resources in education become an economic powerhouse and enjoy high level of productivity. Examples of those countries includes Japan, Taiwan, China etc. In Nigeria, the rate of out of schoolchildren in Nigeria increased from 24% in 2010 to 27.2% in 2016/2017. This increase was led from the Northern part of the country, largely influenced by high level of poverty (World Bank Fact, 2018). Bauchi, Gombe and Jigawa have the highest percentage of out of schoolchildren at the Primary compared to Lagos, Anambra, Abia, Ondo and Edo, which has the lowest percentage of out of schoolchildren (Figure 2).

Figure 2: Percentage of out-of-school children by State in Nigeria (Primary)



Source: Adapted from World Bank, 2018. Investing in Human Capital for Nigeria's future

The increasing number of out-school children in the country calls for urgent attention of both the State and Local Government Authorities to provide a quality access to education rather than the Federal Government intervening in the primary education projects. The Federal Government established the Universal Basic Education to improve basic education delivery with the aim of eradicating illiteracy, ignorance, poverty and ensuring national development. To operationalize the national agenda, every state has established a state Universal Basic Education Board. Efforts are being made at the sub-national level to ensure that people at the grassroots have access to education. A good example is the school-feeding program introduced by the Abia State Government, the construction of 304 classroom blocks had a positive effect on the number of public-school enrollment; as the number rose from 142,000 in 2015 to 648,271 pupils, indicating the importance of good policy direction to increase social gains (World Bank, 2018).

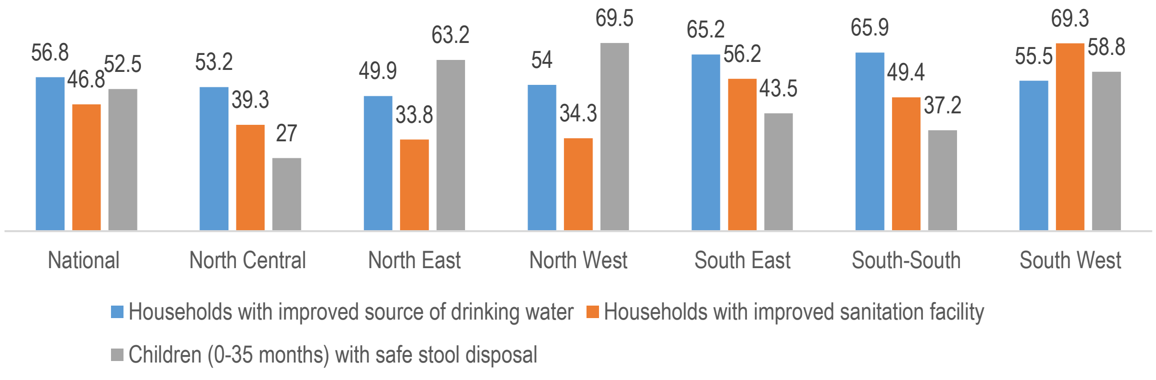
1.1.2 Health Sector and Nutrition

A healthy and well-nourished population creates better communities and generates revenue for the country. Sub-nationals are responsible for secondary hospitals and manage the operations of primary health care services. The state of the health sector is poor especially in the rural areas where the local citizens have limited access to health care facilities, inadequate medical instruments and supplies, shortage of quality staff at the health centers. The sector is today still largely manual and automation of processes and adoption of state-of-the-art technology for diagnostics and services is still lacking in many areas.

Statistics reported an alarming rate of acute malnutrition, ranging from 5 - 9.9% since 2014. This has been the prevailing cause of child mortality rate of under – five aged children (UNICEF, 2019). Women and children in the northern region are at a higher risk of suffering from malnutrition. A survey conducted by National Bureau of Statistics reported that Jigawa State has the highest incidence of acute malnutrition standing at 10%. It is therefore relevant for state actors to investment in nutrition sensitive to geographic location, gender and age to reduce the high incidence of malnutrition in the states. In addition, HIV/AIDS contributes significantly to the mortality rate among the age group 15 - 49, followed by diarrhea, maternal disorders and tuberculosis.

Water and sanitation are key to improving the state of health of citizens, however, water and sanitation are still sub-optimal in the country with only 57% of households having access to portable water supply and 43% can access improved sanitation facility. A survey conducted by National Bureau of Statistics indicated that the that South –South, South West and North West regions have the highest proportions of improved water source, sanitation facilities and safe disposal of child waste compared to North East and North Central which has the lowest proportion of portable water supply and sanitation(Figure 3).

Figure 3: Access to portable water and sanitation (% of total population in State)



Source: National Bureau of Statistics, June 2018. *National Nutrition and Health Survey*

2 Role of the AfDB in Supporting Sub-national Development

The Africa Development Bank’s interventions at all level (federal/subnational) are focused on the Bank’s Hi 5s priorities: Feed Africa, Light and Power Africa, Industrialize Africa, Integrate Africa, improve the quality of life of people. In line with the High 5 and the Economic Recovery and Growth Plan (ERGP), the Bank's operation in Nigeria during the period 2013-2019 are informed by 2 strategic pillars : (i) Supporting the Development of a Sound Policy Environment and Social Inclusion, (ii) Investing in Critical Infrastructure to Promote the Development of the Real Sector of the Economy.

There are several areas where the Bank alongside other DFI, are supporting and will continue to support sub-national development:

1. **Governance:**
   - Debt Management : Grant-funded Technical Assistance provided to DMO to strengthen Debt Management functions at State level
   - Domestic Resources Mobilization and strengthening Public Financial Management (procurement, financial management)
   - Capacity development to improve subnational procurement procedures through training to Project Implementation Units (PIUs).

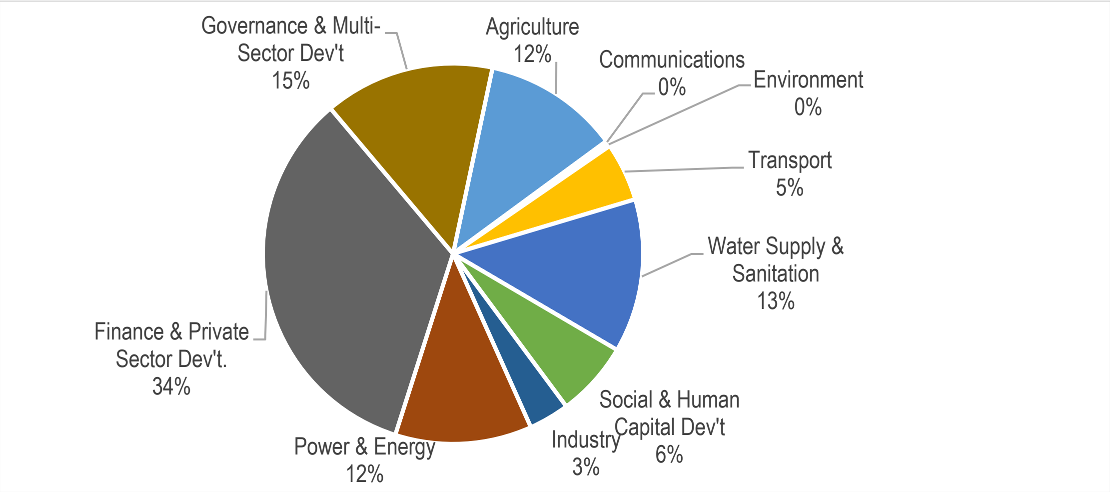
2. **Infrastructure Development to attract private sector financing – going forward to be focused on establishing agro-industrial processing zones:**
   - The Bank finances infrastructure projects at sub-national level in various such sectors transportation, water and sanitation, energy (mini-grids, renewable, etc),
   - *Particularly in agriculture, the Bank is promoting the establishment of special agro-industrial processing zones;*
   - Support to Small and Medium Scale Enterprise through Line of Credits

3. **Human Capital Development:**

Addressing human capital development challenges at subnational level.

- Skills Development (with emphasis on science and technology) for Job creation,
- Coding for Employment
- Health and Nutrition: planned Malaria and nutrition project in Anambra and Ondo States.

Figure 4: Bank' support across the sectors



Conclusion

Development partners are key actors in subnational development and can support states in formulation and implementation of transformative policies and programs. However, their interventions can sometimes be constrained by political interference in key operational decision. Their excellences the Governors strong support is therefore **needed to help fast-track project implementation** considering the undue cost to the country and particularly to the beneficiaries.

Table 1: Current active portfolio of the Bank

Project Description	Implementing States	Amount (US$ m)
Abuja Bus Rapid Transit (BRT) Project Study	Abuja FCT	0.98
Agricultural Transformation Agenda Support Program - Phase I	Kano, Jigawa, Kebbi, Sokoto, Niger, Anambra, Enugu, and FCT Abuja	138.74
Jigawa Solar Independent Power Procurement Programme - Phase I	Jigawa	1.40
Study Grant for Rehabilitation of Industrial Clusters	Bauchi, Kano, Katsina, Edo, Enugu, Abuja FCT, Lagos, Kwara, Plateau, Borno, Benue, Niger, Cross River, Osun, Imo, Rivers, Sokoto, Akwa Ibom, Taraba, Adamawa, Kaduna.	0.56
Nigeria-Cameroon Highway-Transport Facilitation Program on the Bamenda-Mamfe-Ekok-Abakaliki-Enugu Corridor	Enugu, Cross Rivers, Ebonyi	286.72
Plateau State Potato Value Chain Support Project (PS-PVCP)	Plateau	11.20
Preparation of Komadugu-Yobe Basin Strategic Development Plan	Yobe	2.24
Rural Water Supply and Sanitation Sub-Programmes for Yobe and Osun	Federal, Yobe, Osun	71.40
Urban Water Reform & Port Harcourt Project	Federal and Port-Harcourt	203.70
Nigeria Electrification Project	Niger, Sokoto, Ogun, Plateau, Cross River, Adamawa, Katsina, Nasarawa, Kogi, Imo, Rivers, Akwa Ibom, Ondo	200.62
Ebonyi State Ring Road Project	Ebonyi State	70.00
Zaria Water and Sanitation Expansion Project	Kaduna	89.46
Urban Water Reform & Sanitation Improvement in Oyo and Taraba	Federal, Oyo and Taraba	70.00

Reference:

UNICEF (2019). *Health & HIV*. [online] Available at: https://www.unicef.org/nigeria/health-hiv [Accessed 26 Apr. 2019].

World Bank (2018). *Investing in Human Capital for Nigeria's future*. [online] Available at: http://documents.worldbank.org/curated/en/346771542864299850/pdf/132316-21-11-2018-17-31-9-NigeriaBEUAMF.pdf [Accessed 26 Apr. 2019].